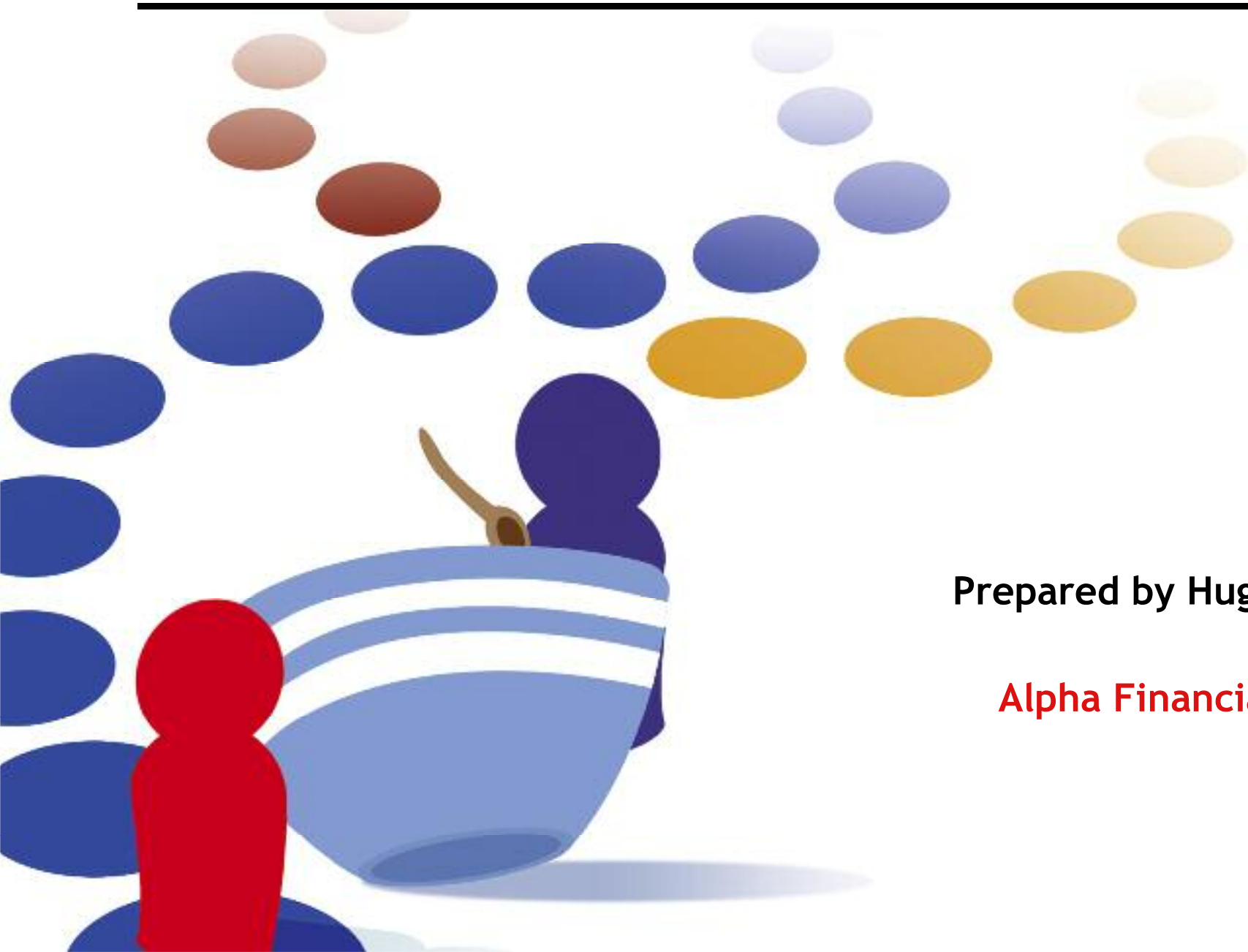


# Model Portfolio Quarterly Review

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Prepared by Hugh Doxat-Pratt

**Alpha Financial Consultants**

March 2009

## The Process

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The economic assumptions that underpin the asset allocation of our model portfolios are produced by Skandia and verified by Watson Wyatt (WW).

It is important to remember that the assumptions used are based on a longer-term view and may not necessarily reflect short-term idiosyncrasies of the markets. More specifically the review covers the following:

- ❏ The return and volatility parameters of various asset classes
- ❏ Correlations between returns on asset classes
- ❏ The risk levels for each of the model portfolios
- ❏ Distribution yields as a percentage of total returns for each relevant asset class
- ❏ The appropriate geographical splits for international equities
- ❏ A commentary on the rationale for any changes to parameters
- ❏ Implied asset allocations for each of the model portfolios

## Who are Watson Wyatt (WW)?

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WW is a global consulting firm. The UK investment practice has significant experience in providing investment strategy advice to the UK's largest institutional investors. They count among their investment clients some 40% of FTSE<sup>®</sup> 100 pension plans and many of the largest non-life insurers.

According to WW, their UK strategy team is the largest in Europe, a position they have achieved by providing market-leading solutions and by delivering true value to their clients. The investment strategy team numbers some 50 associates, with backgrounds in pensions, actuarial, finance and banking. This mix of skills means that they are able to advise on cutting-edge investment solutions.

WW investment views are developed by their Global Investment Committee, which is supported by a dedicated asset research team, and is able to leverage the knowledge of their 75-strong global manager research team.

## WW summary for quarter ending 20 March 2009

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Following the latest Watson Wyatt (WW) review of the economic parameters underpinning the Skandia investment model, you will not be surprised to learn that there have been significant changes to the Skandia asset allocations. For the higher risk OEIC portfolios, there has been an increase in exposure to UK fixed interest and international equity, at the expense of UK equity and property. For other portfolios we have seen an increase in property and international equity allocations, again at the expense of UK equity and UK fixed interest.

The following is a summary of the WW report, and the main changes to the assumptions.

Economic conditions remained hugely uncertain and financial markets continued to be very volatile throughout the latest quarter (Q4 2008). WW believes we are currently in an abnormal, possibly 'depressionary', environment that may last for some time before more 'normal' conditions resume. Therefore, in a number of areas, WW's short-term best estimates differ significantly from its views of longer-term central outcomes. As a result, it has developed its model to assume short-term 'abnormal' conditions for a period of 5 years, followed by a return to more 'normal' conditions as the action of policymakers restore stability to the economy.

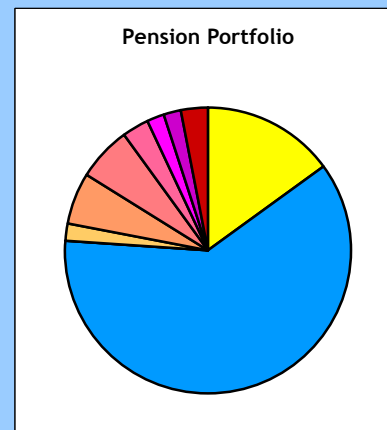
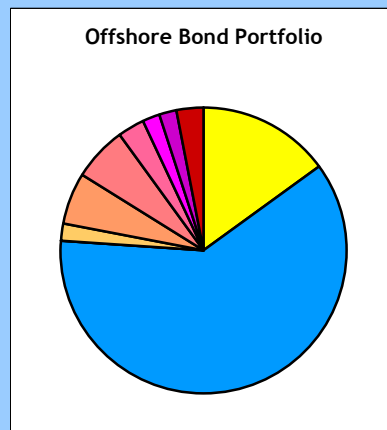
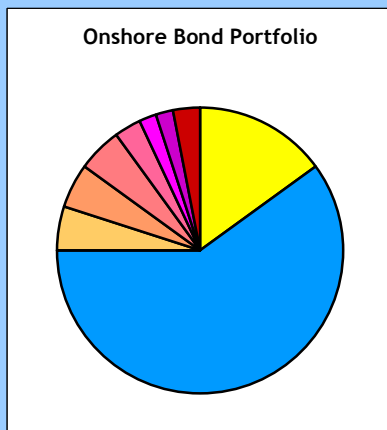
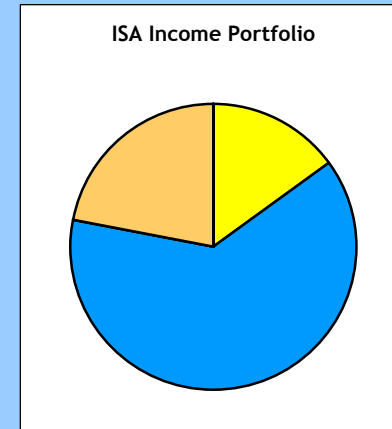
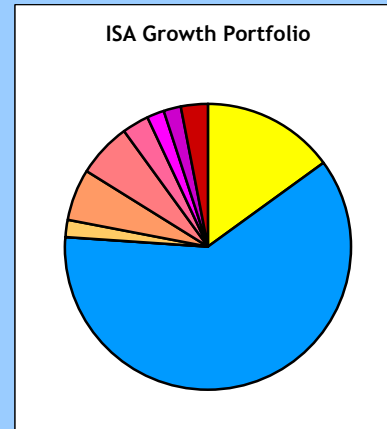
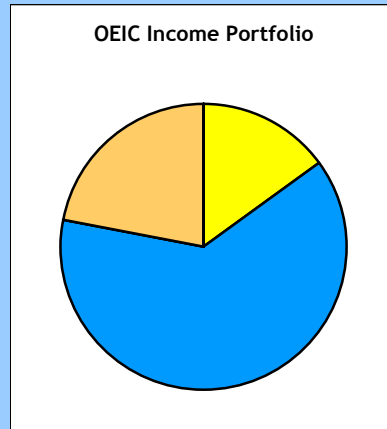
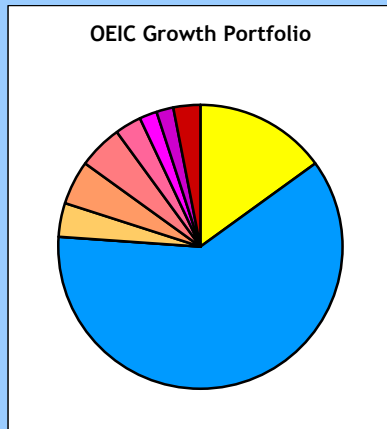
The main highlights of the changes made to the asset assumptions were as follows:

- ★ For the first time since the WW derived asset allocations were launched in 2001, it has recommended a cap on property allocations at 15%. This is to account for the prevailing lack of liquidity associated with bricks and mortar property funds. Presently there are a number of property funds which are closed to redemptions due to high demand for withdrawals, along with a desire to prevent fire-sale valuations on properties being sold to meet that demand. WW sees this as an unaccounted for risk, and thus recommended a cap on property asset allocations, setting the level at 15%.
- ★ The inflation assumption has been made time-dependent. The inflation assumption stands at 0% in year one increasing to a long-term average of 3% uniformly over the first five years.
- ★ Lower inflation expectations resulted in lower than expected nominal returns, all other things being equal, for every asset class in the first five years of the simulation. Nominal returns in the latter five years return to WW's long-term average range. WW's real cash return assumptions fell by 0.5% per annum in line with moves by central banks to reduce interest rates to stimulate economic activity.
- ★ WW has significantly increased the volatility of nominal bonds in the model.
- ★ The correlation between equities and bonds has fallen, to reflect the risk-averse world that WW now believes that we live in.
- ★ Owing to market volatility, WW has increased its short term equity volatility assumption again this quarter. They assume that equity volatility levels will decrease to long-term volatility levels over time.
- ★ The proportion of total return derived from distribution yields has been increased for both equities and property.

# CONSERVATIVE PORTFOLIO

Target Annualised Volatility Range: 5.750% - 7.970%

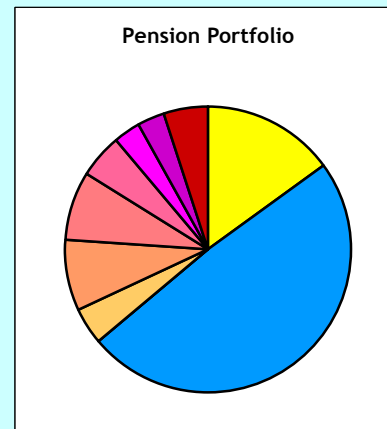
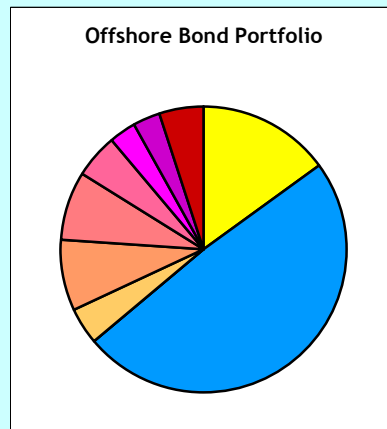
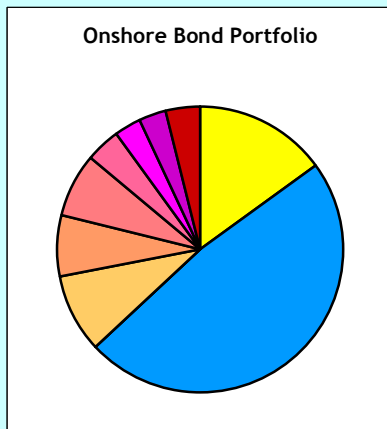
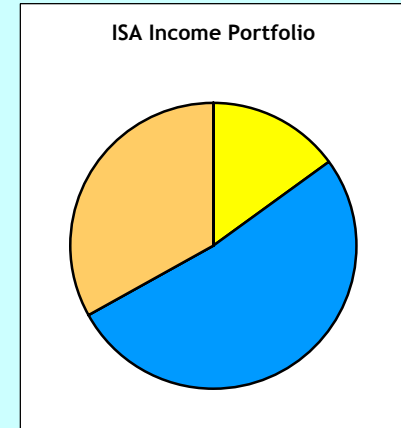
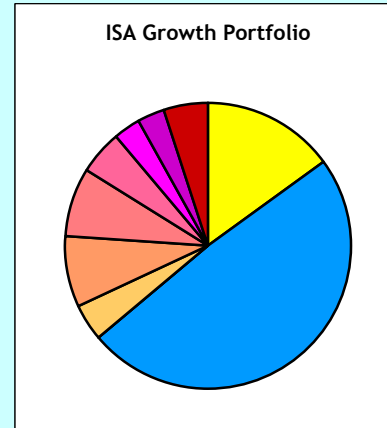
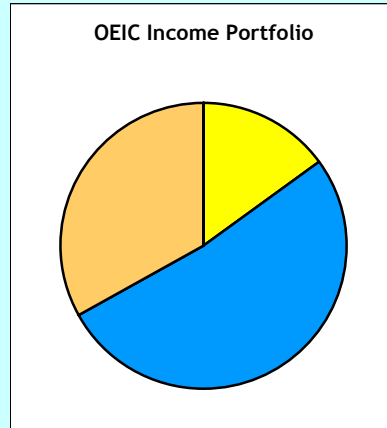
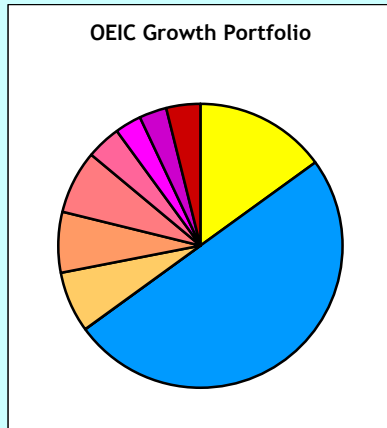
Best fit for Risk Tolerance Scores: 29-42



# MODERATE CONSERVATIVE PORTFOLIO

Target Annualised Volatility Range: 7.970% - 9.940%

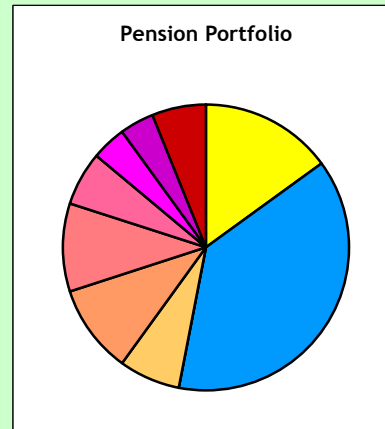
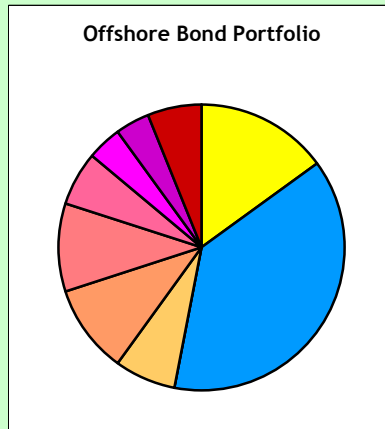
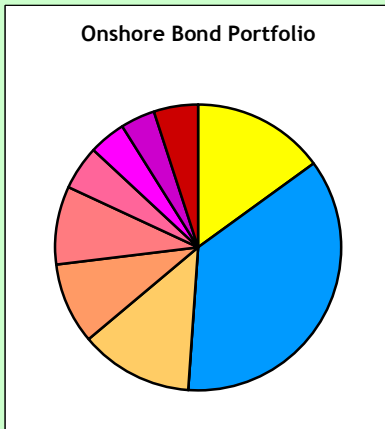
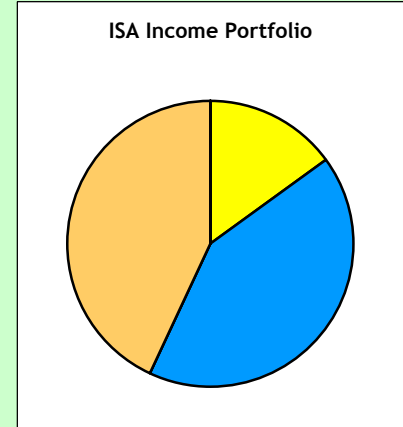
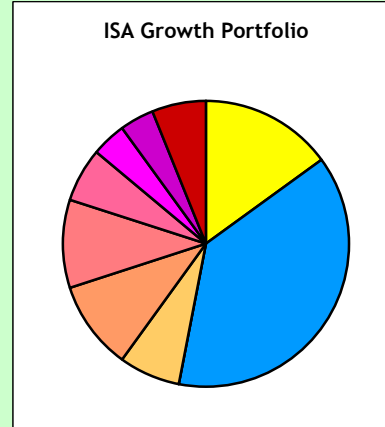
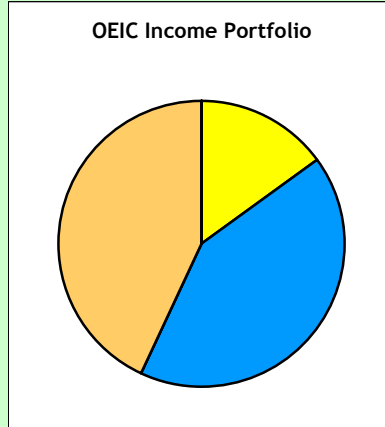
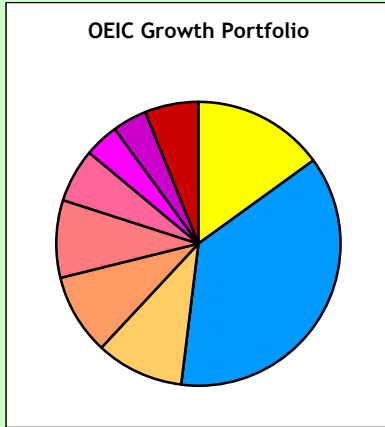
Best fit for Risk Tolerance Scores: 43-51



# MODERATE PORTFOLIO

Target Annualised Volatility Range: 9.940% - 11.900%

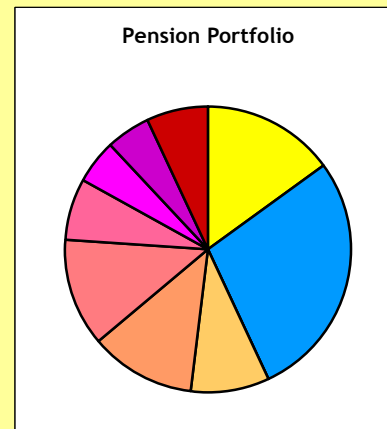
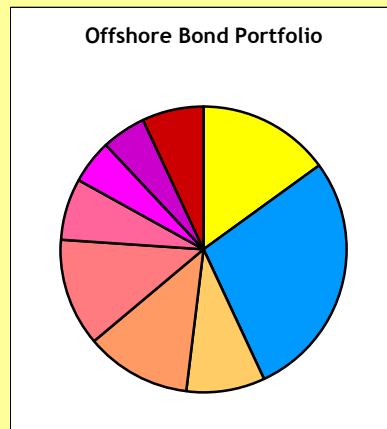
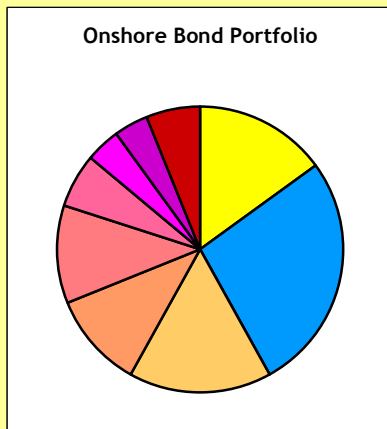
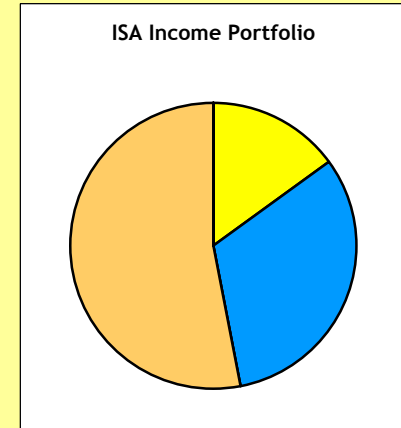
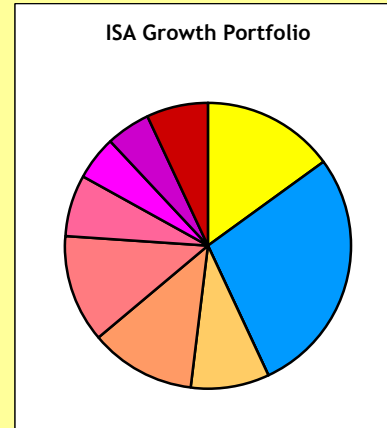
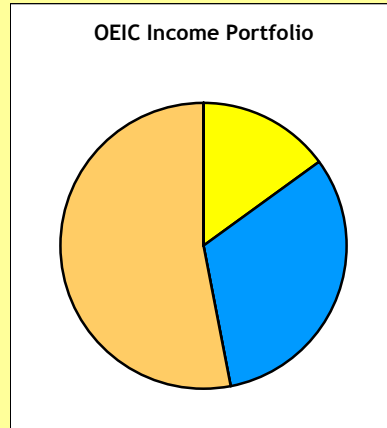
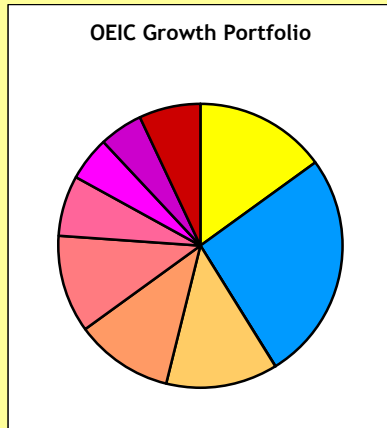
Best fit for Risk Tolerance Scores: 52-59



# BALANCED PORTFOLIO

Target Annualised Volatility Range: 11.900% - 13.870%

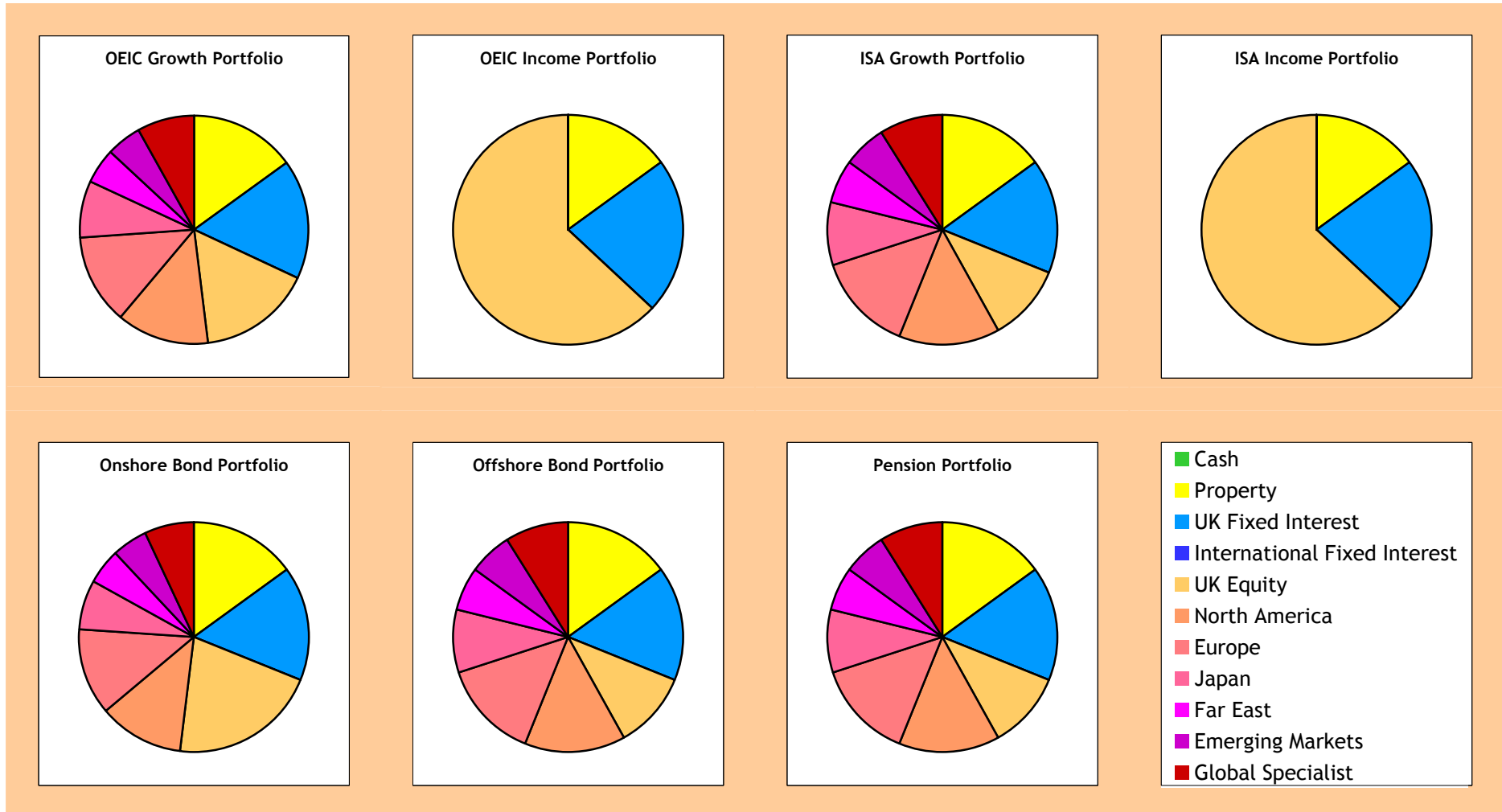
Best fit for Risk Tolerance Scores: 60-67



# MODERATE AGGRESSIVE PERFORMANCE

Target Annualised Volatility Range: 13.870% - 15.830%

Best fit for Risk Tolerance Scores: 68-76



# AGGRESSIVE PORTFOLIO

Target Annualised Volatility Range: 15.830% - 17.350%

Best fit for Risk Tolerance Scores: 77-89

